MARKET COMMENTARY

EQUITY ANALYSIS

THE ILLUSION OF PERPETUAL GROWTH

Stock prices are more than numbers on a screen. They tell us what market participants believe. These beliefs are distilled into prices that reveal investors' changing expectations about the future. The expectations are not those of a CEO or a handful of analysts — they are the aggregate judgment of all the actual buyers and sellers of stocks who set prices each day.

By applying a basic valuation framework[1] to the five hundred largest U.S. companies, we can tease out what the market assumes about *long-run growth in perpetuity*. This is not about next quarter or even the next decade. It is about what investors seem to collectively believe will happen — now and forever. The recent run-up in high flying growth and AI stocks suggests this is a good time to revisit where growth expectations and valuations intersect.

The charts on page 4 show the distribution of growth expectations priced into S&P 500 stocks in 2015 and now. We show that there are far more companies today whose valuations are predicated upon realization of growth rates well beyond the growth that the economy is likely to deliver. In the charts, a red dashed line marks 5 percent and is labeled "GDP Growth." That marker is not arbitrary. In the past decade, U.S. nominal GDP grew at an average annual rate of roughly 5.4 percent; looking ahead, the Congressional Budget Office projects nominal GDP closer to 4 percent over the coming decade. Against that backdrop, the market's current pricing is striking. When more growth expectations exceed this level of about 5%, we believe the chances for disappointment grow and losses can be significant. This is why we maintain conservative growth estimates when valuing companies.

A decade ago, the market was conservatively estimating growth. For example, in 2015, the market implied perpetuity growth rate baked into S&P 500 companies' valuations clustered around a reasonable 3–5 percent (blue bars in Chart A top, page 4), with only a minority priced above the economy's long-run growth (orange bars). Roughly seven in ten firms were priced with growth expectations at or below overall GDP growth. The market's center of gravity sat near the system's anchor.

Today the distribution looks very different (Chart A bottom, page 4). Growth expectations are now much higher on average, and there is a far thicker concentration of companies with growth expectations *above* the economy's trend (orange bars). A large share of firms now rests on the assumption that growth will outpace GDP in *perpetuity*. Looked at by market capitalization (rather than numbers of companies), the tilt is even more pronounced: *over 60% of the S&P 500 index value is priced as if superior growth can be sustained forever,* with a meaningful slice (about $8 trillion in market value) priced with an *implied perpetuity growth assumption above 10%.*

THE PROBLEM WITH PERPETUITY

Here is the central problem: *no company can grow faster than the economy forever.* The math simply will not allow it. A firm compounding at 10 percent while the economy grows at 5 percent eventually overtakes the economy itself — an impossibility. Compounding exposes the flaw.

History points the same way. Champions of one era rarely dominate the next. Competition, technology, and regulation erode even the strongest franchises. IBM, Intel, General Electric, General Motors — each at times seemed impervious to the law of large numbers and competition. But each one aged in time and growth slowed. Yet the market periodically assumes a new "fountain of youth" for a new crop of companies, but ascent, challenge, and mean reversion will remain the rule. Over time, growth must converge toward the pace of the economy and system as a whole.

WHAT THE MARKET IS REALLY SAYING

If above-GDP growth “in perpetuity” is impossible, what do today’s prices mean? They reflect *optimism* and *imprecision* — the belief that a few special firms can maintain extraordinary advantages for an unusually long time, as if forever. We see this in the evolution of Chart A on page 4. The chart also shows that distribution also has a heavy *left tail*: some companies are priced as if they will shrink indefinitely. *This polarization — exuberance for perceived “permanent” winners and resignation about “permanent” losers — is a snapshot of sentiment, not an equilibrium that can endure.*

WASHINGTON CROSSING ADVISORS’ APPROACH

To highlight the contrast, we now show two distributions (Chart B, page 4): the *current* market-implied growth for the S&P 500 companies and *Washington Crossing Advisors*’ own internal assumptions used in our intrinsic-value work on high quality dividend growth stocks, which we identify using the WCA High Quality Index. While many companies are being priced with heady growth expectations, we use far more conservative assumptions — generally clustered around *3–5 percent*, with very few of our assumptions set above estimated long-run GDP growth (5 percent). The aim here is straightforward: reduce the risk of overpaying for narratives that require impossible things to happen. If market valuations later realign with more realistic expectations, we expect better entry points for quality firms currently *priced to perfection or beyond*.

TODAY’S DILEMMA

For investors, this environment carries opportunity and danger. The danger is apparent: when expectations are stretched, small disappointments can trigger large drawdowns. We saw this in spades in the 2000-2002 market meltdown. The opportunity lies in the other direction: firms priced for secular decline may prove more resilient, offering value precisely because they have been written off.

Perhaps the broader lesson is *patience and humility*. Prices can and do embed unreasonable growth assumptions, but over time the economy imposes discipline. This is why economics and markets are inextricably tied. Markets’ expected growth must ultimately reconcile with the broader economy’s ability to deliver that growth. Forgetting this invites delusion — and potentially severe and rapid losses when the stock market’s moorings to fundamentals become untethered. And this is precisely why Washington Crossing Advisors maintains a valuation *discipline* alongside an emphasis on quality and income growth. Where we can buy quality businesses *without* assuming the impossible, we believe risk and reward are more sensibly aligned.

1 Gordon Growth Model (Enterprise View). The Gordon Growth model values a stream of cash flows assuming a constant growth rate into perpetuity. In our application, we take an enterprise-value perspective: we subtract the cash-flow-to-EV yield from the firm’s weighted average cost of capital (WACC). The difference is the implied long-run (perpetuity) growth rate embedded in today’s price.

CHART A | EVOLVING GROWTH EXPECTATIONS (2015 vs. 2025) Source: Bloomberg, WCA Calculations

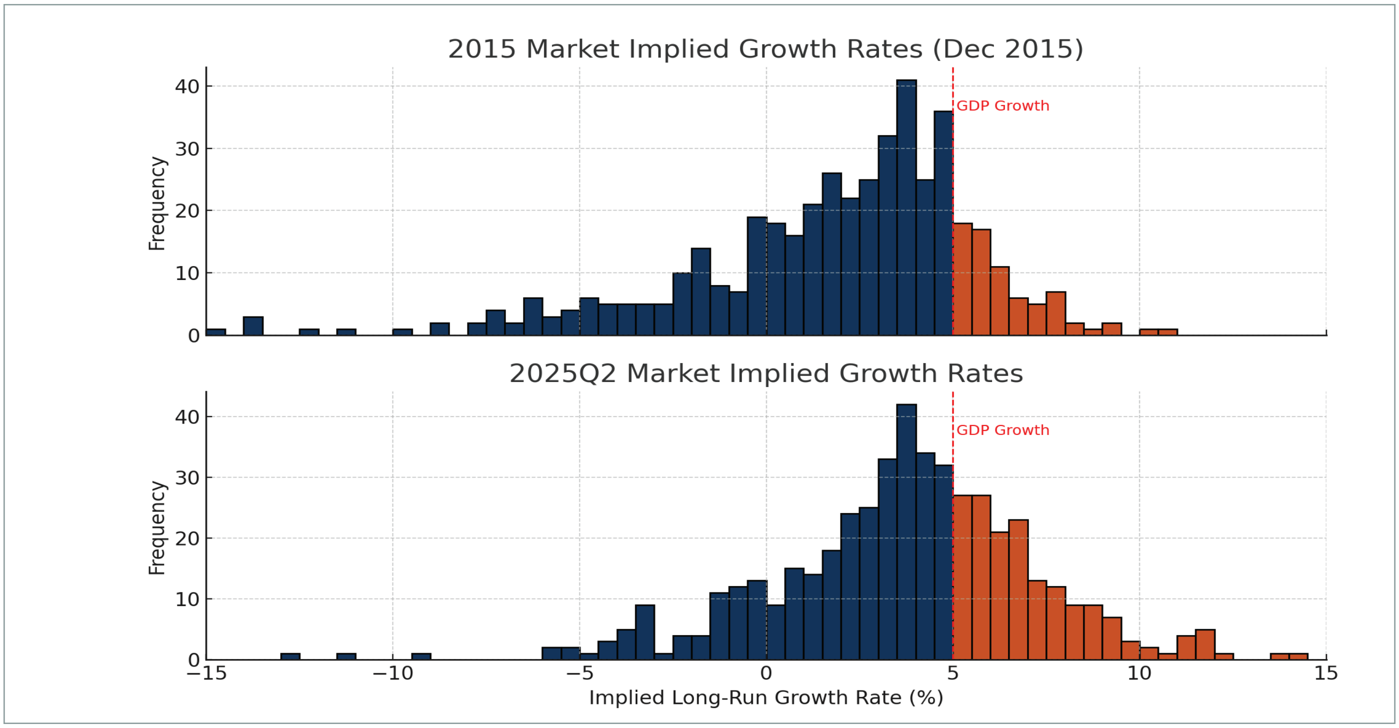
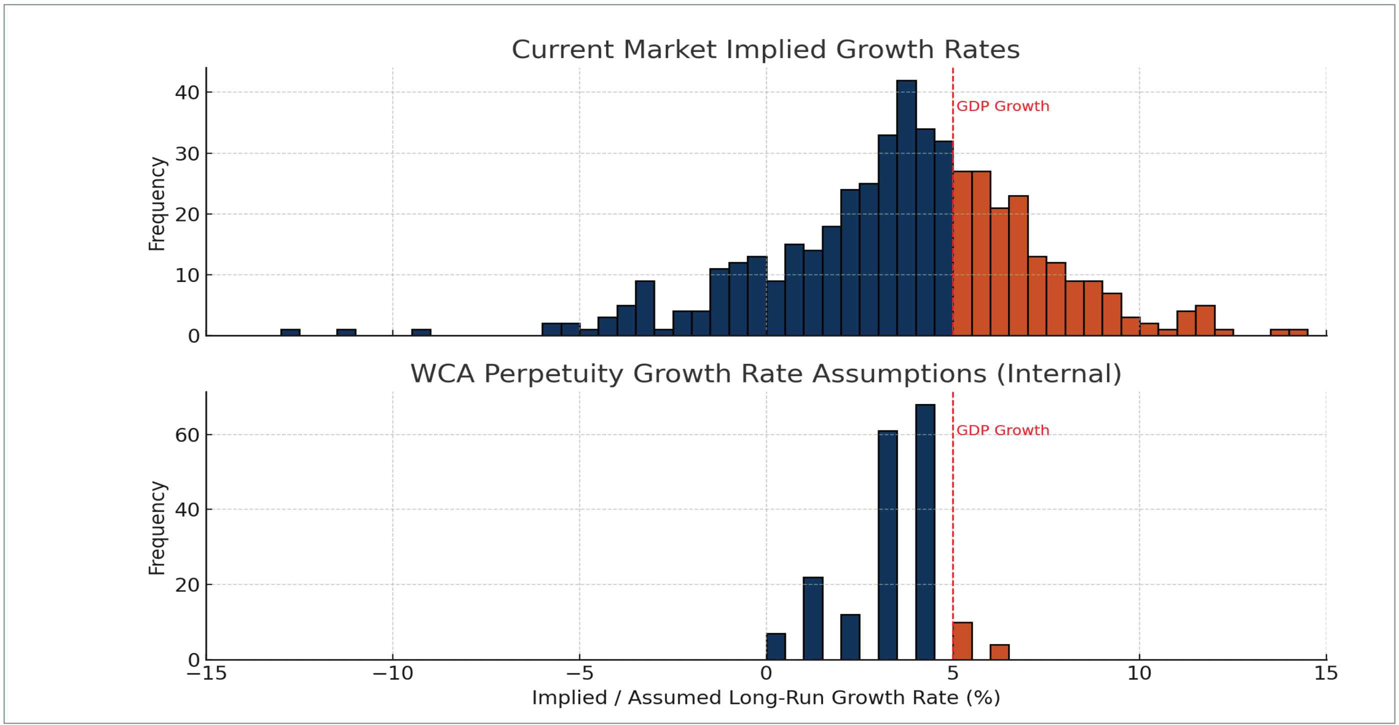


CHART B | WCA APPROACH Source: Bloomberg, WCA Calculations, Internal Valuation Assumptions



IMPORTANT DISCLOSURES

Standard & Poor's 500 Index (S&P 500) is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

The Washington Crossing Advisors' High Quality Index and Low Quality Index are objective, quantitative measures designed to identify quality in the top 1,000 U.S. companies. Ranked by fundamental factors, WCA grades companies from "A" (top quintile) to "F" (bottom quintile). Factors include debt relative to equity, asset profitability, and consistency in performance. Companies with lower debt, higher profitability, and greater consistency earn higher grades. These indices are reconstituted annually and rebalanced daily. For informational purposes only, and WCA Quality Grade indices do not reflect the performance of any WCA investment strategy.

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Beta is a measure of the volatility, or systematic risk, of a security or a portfolio relative to the market as a whole. A beta of one is considered as risky as the benchmark and is therefore likely to provide expected returns approximate to those of the benchmark during both up and down periods. A portfolio with a beta of two would move approximately twice as much as the benchmark.

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FOR MORE INFORMATION, PLEASE CONTACT US:

Washington Crossing Advisors

- **Kevin R. Caron, CFA,** Senior Portfolio Manager | (973) 549-4051
- **Chad Morganlander,** Senior Portfolio Manager | (973) 549-4052
- **Matthew Battipaglia,** Portfolio Manager | (973) 549-4047
- **Steve Lerit, CFA,** Head of Portfolio Risk Management | (973) 549-4028
- **Suzanne Ashley,** Relationship Manager | (973) 549-4168

Sales and Marketing

- **Eric Needham, Director,** External Sales and Marketing | (312) 771-6010
- **Jeffrey Battipaglia,** Client Portfolio Manager | (973) 549-4031

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